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PLR-112716-08

Date:

June 20, 2008

LEGEND

Distributing =

Controlled 1 =

Controlled 2 =

Q1 =

Q2 =

Revocable Trust =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

State X =

State Y =

State Z =

Brand A =

Business 1 =

Division A =

Division B =

Division C =

Division D =

Grantor =

BB% =

CC% =

Dear :

This letter responds to your January 31, 2008, letter requesting rulings on certain federal income tax consequences of the Proposed Transaction (described below). The information provided in that letter and in later correspondence is summarized below.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. This office has not verified any of the materials submitted in

support of the request for rulings. Verification of the information, representations, and other data may be required as part of the audit process.

Moreover, this office has not reviewed any information pertaining to, and has made no determination regarding, whether the Distributions (described below): satisfy the business purpose requirement of Treas. Reg. § 1.355-2(b); (ii) are used principally as a device for the distribution of the earnings and profits of the distributing corporation or the controlled corporation or both (see section 355(a)(1)(B) of the Internal Revenue Code (the “Code”) and Treas. Reg. § 1.355-2(d)); or (iii) are part of a plan (or series of related transactions) pursuant to which one or more persons will acquire directly or indirectly stock representing a 50-percent or greater interest in the distributing corporation or the controlled corporation (see section 355(e)(2)(a)(ii) and Treas. Reg. § 1.355-7).

FACTS

Distributing is an S corporation formed in State X with an initial S election filed on Date 1. Distributing has a single class of voting common stock.

Distributing’s sole shareholder currently is Revocable Trust. Grantor owns all interests in the Revocable Trust. It is represented that Revocable Trust became the sole shareholder of Distributing on Date 1. All voting rights, except for certain voting rights maintained by the trust certificate holder, with respect to the Distributing stock have been transferred to an eligible voting trust under Treas. Reg. § 1.1361-1(h)(1)(v) (the “Distributing Voting Trust”) in exchange for trust certificates. Revocable Trust currently holds those trust certificates. All distribution rights with respect to Distributing stock belong to the Revocable Trust.

Controlled 1 was incorporated as a State X corporation on Date 2. It has been represented that Controlled 1 is presently a qualified subchapter S subsidiary (“QSub”) of Distributing.

A voting trust (the “Controlled 1 Voting Trust”) holds BB% of all the Controlled 1 stock. Under the trust agreement, the trustees of the Controlled 1 Voting Trust have legal title to all of the Controlled 1 stock held by the Controlled 1 Voting Trust and the trustees have exclusive voting rights with regard to this stock for the period of the trust (except for certain voting rights maintained by the trust certificate holders).

Distributing owns voting trust certificates (the “Controlled 1 Voting Trust Certificates”) representing all of the Controlled 1 shares held by the Controlled 1 Voting Trust. Any cash dividends with respect to the Controlled 1 stock are to be paid by the Controlled 1 voting trustees to the Controlled 1 Voting Trust certificate holder. Upon the termination of the Controlled 1 Voting Trust the Controlled 1 shares will be returned to the trust certificate holder. Distributing holds all legal and beneficial ownership with regard to the remaining CC% of the Controlled 1 stock.

For at least the last five years Controlled 1 has operated Division A of Business 1 in State X.

Controlled 2 was incorporated by Distributing as a State Y corporation on Date 3. It has been represented that Controlled 2 is presently a qualified subchapter S subsidiary ("QSub") of Distributing.

A voting trust (the "Controlled 2 Voting Trust") holds all of the Controlled 2 stock. Under the trust agreement, the trustees of the Controlled 2 Voting Trust have legal title to all of the Controlled 2 stock and have exclusive voting rights for the period of the trust (except for certain voting rights maintained by the trust certificate holders).

Distributing owns voting trust certificates (the "Controlled 2 Voting Trust Certificates") representing all of the Controlled 2 shares held by the Controlled 2 Voting Trust. Any cash dividends with respect to the Controlled 2 stock are to be paid by the Controlled 2 voting trustees to the Controlled 2 Voting Trust certificate holder. Upon the termination of the Controlled 2 Voting Trust the Controlled 2 shares will be returned to the trust certificate holder.

On Date 4, Controlled 2 acquired Division B and Division D of Business 1. Controlled 2 currently operates Division B and Division D of Business 1 in State Y.

Q1 was incorporated as a State Z corporation on Date 5 (a date before Date 3). It is represented that Q1 is presently a qualified subchapter S subsidiary ("QSub") of Distributing. For over five years Q1 has operated Division C of Business 1 in State X.

A voting trust (the "Q1 Voting Trust") holds all of the Q1 stock. Under the trust agreement, the trustees of the Q1 Voting Trust have legal title to all of the Q1 stock and have exclusive voting rights for the period of the trust (except for certain voting rights maintained by the trust certificate holders).

Distributing owns Q1 Voting Trust certificates representing all of the Q1 shares held by the Q1 Voting Trust. Any cash dividends with respect to the Q1 stock are to be paid by the Q1 voting trustees to the Q1 Voting Trust certificate holder. Upon the termination of the Q1 Voting Trust the Q1 shares will be returned to the trust certificate holder.

The distribution of the stock, or stock and securities, of Controlled 1 and Controlled 2 is carried out for the following corporate business purposes: (1) To provide more availability for using current assets to expand the Brand A operations within the Controlled corporations to be spun off; and (2) To provide more availability for using current assets to expand the operations within the Distributing corporation.

Financial information has been received indicating that Business 1 has gross receipts and operating expenses representative of the active conduct of a trade or business for each of the past five years.

PROPOSED TRANSACTION

To achieve the corporate business purposes described above, Distributing has proposed the following transactions (collectively, the “Proposed Transaction”).

- (i) Distributing will form Q2 as a new subsidiary and make a QSub election for Q2.
- (ii) Controlled 2 will transfer Division D of Business 1 to Q2.
- (iii) Distributing will distribute all of the Controlled 1 Voting Trust Certificates to Revocable Trust. Distributing will distribute the Controlled 1 stock (not held by the Controlled 1 Voting Trust) to Revocable Trust (hereinafter referred to as “Distribution 1”).
- (iv) Immediately following Distribution 1, Controlled 1 will elect under § 1362(a) to be treated as a S corporation.
- (v) Distributing will distribute all of the Controlled 2 Voting Trust Certificates to Revocable Trust (hereinafter referred to as “Distribution 2”).
- (vi) Immediately following Distribution 2, Controlled 2 will elect under § 1362(a) to be treated as a S corporation.

REPRESENTATIONS

The following representations are made with respect to Distribution 1:

- (a) The indebtedness (if any) owed by the Controlled 1 corporation to the Distributing corporation after the distribution of the Controlled 1 corporation stock will not constitute stock or securities.
- (b) No part of the consideration to be distributed by the Distributing corporation will be received by a shareholder as a creditor, employee, or in any capacity other than that of a shareholder of the corporation.
- (c) The five years of financial information submitted on behalf of the Distributing corporation is representative of the corporation’s present operation, and with

regard to such corporation, there have been no substantial operational changes since the date of the last financial statements submitted.

- (d) The five years of financial information submitted on behalf of the business contributed to Controlled 1 is representative of the business's present operation, and with regard to such business, there have been no substantial operational changes since the date of the last financial statements submitted.
- (e) Following the transaction, Distributing and Controlled 1 will each continue, independently and with separate employees, the active conduct of its share of all the integrated activities of the business conducted by the distributing corporation prior to the consummation of the transaction.
- (f) The distribution of the stock, or stock and securities, of Controlled 1 is carried out for the following corporate business purposes: (i) To provide more availability for using current assets to expand the Brand A operations within the controlled corporation to be spun off; and (ii) to provide more availability for using current assets to expand the operations within the Distributing corporation. The distribution of the stock, or stock and securities, of Controlled 1 is motivated, in whole or substantial part, by one or more of these corporate business purposes.
- (g) The transaction is not used principally as a device for the distribution of the earnings and profits of the distributing corporation or the controlled corporation or both. See § 355(a)(1)(B).
- (h) The total adjusted basis and the fair market value of the assets transferred to Controlled 1 will equal or exceed the sum of: (i) the total liabilities assumed (within the meaning of § 357(d)) by Controlled 1, and (ii) the total amount of any money and the fair market value of any other property (within the meaning of § 361(b)) received by Distributing and transferred to creditors in connection with the reorganization.
- (i) The liabilities assumed (within the meaning of § 357(d)) by Controlled 1 were incurred in the ordinary course of business and are associated with the assets being transferred.
- (j) The total fair market value of the assets transferred to Controlled 1 will exceed the sum of: (i) the amount of any liabilities assumed (within the meaning of § 357(d)) by Controlled 1 in connection with the exchange, (ii) the amount of any liabilities owed to Controlled 1 by Distributing that are discharged or extinguished in connection with the exchange, and (iii) the amount of any cash and the fair market value of any other property (other

than stock and securities permitted to be received under § 361(a) without the recognition of gain) received by Distributing in connection with the exchange.

- (k) The fair market value of the assets of Controlled 1 will exceed the amount of its liabilities immediately after the exchange.
- (l) The aggregate fair market value of the assets transferred to Controlled 1 will equal or exceed the aggregate adjusted basis of these assets.
- (m) No intercorporate debt will exist between Distributing and Controlled 1 at the time of, or subsequent to, the distribution of the Controlled 1 stock.
- (n) For purposes of § 355(d), immediately after the distribution, no person (determined after applying § 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of Distributing stock entitled to vote, or 50 percent or more of the total value of shares of all classes of Distributing stock, that was acquired by purchase (as defined in §§ 355(d)(5) and (8)) during the five-year period (determined after applying § 355(d)(6)) ending on the date of the distribution.
- (o) For purposes of § 355(d), immediately after the distribution, no person (determined after applying § 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of Controlled 1 stock entitled to vote, or 50 percent or more of the total value of shares of all classes of Controlled 1 stock, that was either (i) acquired by purchase (as defined in §§ 355(d)(5) and (8)) during the five-year period (determined after applying § 355(d)(6)) ending on the date of the distribution, or (ii) attributable to distributions on Distributing stock or securities that were acquired by purchase (as defined in §§ 355(d)(5) and (8)) during the five-year period (determined after applying § 355(d)(6)) ending on the date of the distribution.
- (p) Payments made in connection with all continuing transactions, if any, between Distributing and Controlled 1, will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.
- (q) No two parties to the transaction are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).
- (r) The distribution is not part of a plan or series of related transactions (within the meaning of § 1.355-7) pursuant to which one or more persons will acquire directly or indirectly stock representing a 50 percent or greater interest (within the meaning of § 355(d)(4)) in Distributing or Controlled 1 (including any predecessor or successor of any such corporation).

- (s) Immediately after the distribution, neither Distributing or Controlled 1 will be a disqualified investment corporation (within the meaning of § 355(g)(2)).

The following representations are made with respect to Distribution 2:

- (t) The indebtedness (if any) owed by the Controlled 2 corporation to the Distributing corporation after the distribution of the Controlled 2 corporation stock will not constitute stock or securities.
- (u) No part of the consideration to be distributed by the Distributing corporation will be received by a shareholder as a creditor, employee, or in any capacity other than that of a shareholder of the corporation.
- (v) The five years of financial information submitted on behalf of the Distributing corporation is representative of the corporation's present operation, and with regard to such corporation, there have been no substantial operational changes since the date of the last financial statements submitted.
- (w) The five years of financial information submitted on behalf of the business contributed to Controlled 2 is representative of the business's present operation, and with regard to such business, there have been no substantial operational changes since the date of the last financial statements submitted.
- (x) Except for certain administrative and sales employees that Distributing and Controlled 2 will share the services of, following the transaction, Distributing and Controlled 2 will each continue, independently and with separate employees, the active conduct of its share of all the integrated activities of the business conducted by the distributing corporation prior to the consummation of the transaction.
- (y) The distribution of the stock, or stock and securities, of Controlled 2 is carried out for the following corporate business purposes: (i) To provide more availability for using current assets to expand the Brand A operations within the controlled corporation to be spun off (ii) to provide more availability for using current assets to expand the operations within the Distributing corporation. The distribution of the stock, or stock and securities, of Controlled 2 is motivated, in whole or substantial part, by one or more of these corporate business purposes.
- (z) The transaction is not used principally as a device for the distribution of the earnings and profits of the distributing corporation or the controlled corporation or both. See § 355(a)(1)(B).

- (aa) The total adjusted basis and the fair market value of the assets transferred to Controlled 2 will equal or exceed the sum of: (i) the total liabilities assumed (within the meaning of § 357(d)) by Controlled 2, and (ii) the total amount of any money and the fair market value of any other property (within the meaning of § 361(b)) received by Distributing and transferred to creditors in connection with the reorganization.
- (bb) The liabilities assumed (within the meaning of § 357(d)) by Controlled 2 were incurred in the ordinary course of business and are associated with the assets being transferred.
- (cc) The total fair market value of the assets transferred to Controlled 2 will exceed the sum of: (i) the amount of any liabilities assumed (within the meaning of § 357(d)) by Controlled 2 in connection with the exchange, (ii) the amount of any liabilities owed to Controlled 2 by Distributing that are discharged or extinguished in connection with the exchange, and (iii) the amount of any cash and the fair market value of any other property (other than stock and securities permitted to be received under § 361(a) without the recognition of gain) received by Distributing in connection with the exchange.
- (dd) The fair market value of the assets of Controlled 2 will exceed the amount of its liabilities immediately after the exchange.
- (ee) The aggregate fair market value of the assets transferred to Controlled 2 will equal or exceed the aggregate adjusted basis of these assets.
- (ff) No intercorporate debt will exist between Distributing and Controlled 2 at the time of, or subsequent to, the distribution of the Controlled 2 stock.
- (gg) For purposes of § 355(d), immediately after the distribution, no person (determined after applying § 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of Distributing stock entitled to vote, or 50 percent or more of the total value of shares of all classes of Distributing stock, that was acquired by purchase (as defined in §§ 355(d)(5) and (8)) during the five-year period (determined after applying § 355(d)(6)) ending on the date of the distribution.
- (hh) For purposes of § 355(d), immediately after the distribution, no person (determined after applying § 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of Controlled 2 stock entitled to vote, or 50 percent or more of the total value of shares of all classes of Controlled 2 stock, that was either (i) acquired by purchase (as defined in §§ 355(d)(5) and (8)) during the five-year period (determined after applying § 355(d)(6)) ending on the date of the distribution, or (ii) attributable

to distributions on Distributing stock or securities that were acquired by purchase (as defined in §§ 355(d)(5) and (8)) during the five-year period (determined after applying § 355(d)(6)) ending on the date of the distribution.

- (ii) Payments made in connection with all continuing transactions, if any, between Distributing and Controlled 2, will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.
- (jj) No two parties to the transaction are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).
- (kk) The distribution is not part of a plan or series of related transactions (within the meaning of § 1.355-7) pursuant to which one or more persons will acquire directly or indirectly stock representing a 50 percent or greater interest (within the meaning of § 355(d)(4)) in Distributing or Controlled 2 (including any predecessor or successor of any such corporation).
- (ll) Immediately after the distribution, neither Distributing or Controlled 2 will be a disqualified investment corporation (within the meaning of § 355(g)(2)).

RULINGS-Distribution 1

Based solely on the information submitted and on the representations set forth above, it is held as follows:

- (1) The holder of the Controlled 1 Voting Trust Certificates will be treated as the owner of the Controlled 1 stock held by the Controlled 1 Voting Trust. See Rev. Rul. 71-262, 1971-1 C.B. 110.
- (2) After Distributing's distribution of all of its Controlled 1 stock, Controlled 1 will be treated as a new corporation acquiring all of its assets (and assuming all of its liabilities) immediately before the termination from Distributing in exchange for the stock of Controlled 1. (Section 1.1361-5(b)(1)(i)).
- (3) Distributing's distribution of all of its Controlled 1 stock to Revocable Trust will cause a termination of the QSub elections of Controlled 1 because Controlled 1 will cease to be a wholly owned subsidiary of an S corporation. (Section 1.1361-5(b)(1)(i)).
- (4) The deemed transfer by Distributing to Controlled 1 of the assets in constructive exchange for all of the Controlled 1 stock and the assumption of liabilities followed by the distribution of all the Controlled 1 stock to Revocable Trust, as described above, will be a reorganization within the meaning of § 368(a)(1)(D).

Distributing and Controlled 1 will each be “a party to a reorganization” within the meaning of § 368(b).

- (5) Distributing will recognize no gain or loss upon the transfer of assets to Controlled 1 in exchange for Controlled 1 stock and the assumption of liabilities, as described above (§§ 361(a) and (§ 357(a)).
- (6) Controlled 1 will recognize no gain or loss on the receipt of assets in exchange for Controlled 1 stock (§ 1032(a)).
- (7) Controlled 1’s basis in each asset received from Distributing will equal the basis of such asset in the hands of Distributing immediately prior to the transaction (§ 362(b)).
- (8) Controlled 1’s holding period for each asset received from Distributing will include the period during which Distributing held such asset (§ 1223(2)).
- (9) Revocable Trust will recognize no gain or loss (and no amount will be included in the income of Revocable Trust) upon receipt of all the Controlled 1 stock, as described above (§ 355(a)(1)).
- (10) Distributing will recognize no gain or loss on the distribution of the Controlled 1 stock, as described above (§ 361(c)(1)).
- (11) The aggregate basis of the Distributing stock and Controlled 1 stock received by Revocable Trust after the distribution will be the same as the basis of the Distributing stock in the hands of Revocable Trust immediately before the distribution, allocated in a manner described in accordance with § 1.358-2(a). §§ 358(a), (b), and (c), § 1.358-1(a).
- (12) The holding period of the Controlled 1 stock in the hands of Revocable Trust will include the holding period of the Distributing stock held by Revocable Trust prior to the distribution, provided that the Distributing stock is held as a capital asset on the date of the distribution. § 1223(1).
- (13) As provided in § 312(h), proper allocation of earnings and profits between Distributing and Controlled 1 will be made under § 1.312-10(a).
- (14) Distributing’s momentary ownership of the stock of Controlled 1, as part of the reorganization under § 368(a)(1)(D), will not cause Controlled 1 to have an ineligible shareholder for any portion of its first taxable year under § 1361(b)(1)(B). If Controlled 1 otherwise meets the requirements of a small business corporation under § 1361, Controlled 1 will be eligible to make a subchapter S election under § 1362(a) for its respective first taxable year,

provided that such election is made effective immediately following the termination of its original QSub election. (Section 1.1361-5(c)(2)).

RULINGS-Distribution 2

- (15) The holder of the Controlled 2 Voting Trust Certificates will be treated as the owner of the Controlled 2 stock held by the Controlled 2 Voting Trust. See Rev. Rul. 71-262, 1971-1 C.B. 110.
- (16) After Distributing's distribution of all of its Controlled 2 stock, Controlled 2 will be treated as a new corporation acquiring all of its assets (and assuming all of its liabilities) immediately before the termination from Distributing in exchange for the stock of Controlled 2. (Section 1.1361-5(b)(1)(i)).
- (17) Distributing's distribution of all of its Controlled 2 stock to Revocable Trust will cause a termination of the QSub elections of Controlled 2 because Controlled 2 will cease to be a wholly owned subsidiary of an S corporation. (Section 1.1361-5(b)(1)(i)).
- (18) The deemed transfer by Distributing to Controlled 2 of the assets in constructive exchange for all of the Controlled 2 stock and the assumption of liabilities followed by the distribution of all the Controlled 2 stock to Revocable Trust, as described above, will be a reorganization within the meaning of § 368(a)(1)(D). Distributing and Controlled 2 will each be "a party to a reorganization" within the meaning of § 368(b).
- (19) Distributing will recognize no gain or loss upon the transfer of assets to Controlled 2 in exchange for Controlled 2 stock and the assumption of liabilities, as described above (§§ 361(a) and § 357(a)).
- (20) Controlled 2 will recognize no gain or loss on the receipt of assets in exchange for Controlled 2 stock (§ 1032(a)).
- (21) Controlled 2's basis in each asset received from Distributing will equal the basis of such asset in the hands of Distributing immediately prior to the transaction (§ 362(b)).
- (22) Controlled 2's holding period for each asset received from Distributing will include the period during which Distributing held such asset (§ 1223(2)).
- (23) Revocable Trust will recognize no gain or loss (and no amount will be included in the income of Revocable Trust) upon receipt of all the Controlled 2 stock, as described above (§ 355(a)(1)).

- (24) Distributing will recognize no gain or loss on the distribution of the Controlled 2 stock, as described above (§ 361(c)(1)).
- (25) The aggregate basis of the Distributing stock and Controlled 2 stock received by Revocable Trust after the distribution will be the same as the basis of the Distributing stock in the hands of Revocable Trust immediately before the distribution, allocated in a manner described in accordance with § 1.358-2(a). See §§ 358(a), (b), and (c), § 1.358-1(a).
- (26) The holding period of the Controlled 2 stock in the hands of Revocable Trust will include the holding period of the Distributing stock held by Revocable Trust prior to the distribution, provided that the Distributing stock is held as a capital asset on the date of the distribution. § 1223(1).
- (27) As provided in § 312(h), proper allocation of earnings and profits between Distributing and Controlled 2 will be made under § 1.312-10(a).
- (28) Distributing's momentary ownership of the stock of Controlled 2, as part of the reorganization under § 368(a)(1)(D), will not cause Controlled 2 to have an ineligible shareholder for any portion of its first taxable year under § 1361(b)(1)(B). If Controlled 2 otherwise meets the requirements of a small business corporation under § 1361, Controlled 2 will be eligible to make a subchapter S election under § 1362(a) for its respective first taxable year, provided that such election is made effective immediately following the termination of its original QSub election. (Section 1.1361-5(c)(2)).
- (29) Distributing's formation of Q2, its QSub election with respect to Q2, as well as its contribution of Division D of Business 1 to Q2, will not invalidate either Controlled 2's or Q2's QSub election.

CAVEATS

We express no opinion about the tax treatment of the Proposed Transaction under other provisions of the Code and regulations or the tax treatment of any condition existing at the time of, or effects resulting from, the Proposed Transaction that are not specifically covered by the above rulings. In particular, no opinion is expressed regarding:

- (i) Whether the Distributions satisfy the business purpose requirement of Treas. Reg. § 1.355-2(b);

- (ii) Whether the Distributions are being used principally as a device for the distribution of earnings and profits of Distributing or the controlled corporations. (see section 355(a)(1)(B) and Treas. Reg. § 1.355-2(d));
- (iii) Whether the Distributions are part of a plan (or series of related transactions) pursuant to which one or more persons will acquire directly or indirectly stock representing a 50-percent or greater interest in Distributing or the controlled corporations (see section 355(e) and Treas. Reg. § 1.355-7).

PROCEDURAL STATEMENTS

This ruling letter is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the power of attorney on file with this office, a copy of this letter is being sent to your authorized representative.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of this letter ruling.

Sincerely,

Richard Heinecke
Assistant to the Branch Chief, Branch 6
Office of Associate Chief Counsel
(Corporate)